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DIRECTORATE OF
INTELLIGENCE

Intelligence Memorandum

Possible Resumption Of Soviet Aid To Indonesia

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CENTRAL INTELLIGENCE AGENCY
Directorate of Intelligence
October 1970

INTELLIGENCE MEMORANDUM

POSSIBLE RESUMPTION OF SOVIET AID TO INDONESIA

Introduction

1. The recent arrival in Indonesia of a Soviet team to study the feasibility of completing two Soviet-aided projects abandoned after an abortive Communist coup in September 1965 presages the probable resumption of Soviet economic aid to that country. As part of an Indonesian-Soviet debt settlement of August 1970, the USSR and Indonesia agreed to consider completing a steel mill at Tjilegon and a phosphate fertilizer plant at Tjilatjap. During the past year, Moscow also has made vague offers of aid for other Indonesian development projects. This memorandum assesses the current status of the Soviet-Indonesian economic relationship and suggests the prospects for a renewal of a Soviet economic aid program in Indonesia during the next several years.

Discussion

A Decade of Soviet Aid, 1956-65

Military Assistance

2. By the time of the abortive Communist coup in 1965, the USSR had extended about \$1.4 billion of aid to Indonesia. About \$1.1 billion of the total was allocated for military assistance (see Table 1, Appendix A). Deliveries of Soviet military equipment under seven arms accords concluded between February 1957 and October 1964, totaled about \$860 million before the USSR stopped its arms shipments to Indonesia in 1965. Deliveries included a large variety of naval craft, ranging from missile patrol

Note: This memorandum was prepared by the Office of Economic Research and coordinated within the Directorate of Intelligence.

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boats to a light cruiser (the only cruiser Moscow has sold to a Third World country); late model fighter, bomber, and transport, and utility aircraft; a surface to air missile system; and assorted ground equipment (see Table 2, Appendix A).

3. About one-fourth of the estimated value of Soviet military aid to Indonesia represented discounts from list prices. The balance consisted of credits of up to 10 years at 2% interest, repayable after varying grace periods. Soviet assistance made Indonesia's military -- particularly its navy and air force, which had received about three-fourths of their equipment from the USSR -- heavily dependent on Moscow for spare parts and maintenance. Termination of Soviet deliveries in 1965 severely reduced the operational capability of these services. It led to eventual grounding of most of the aircraft and scrapping of many of the naval vessels. Late in 1970, Djakarta sold four naval units (a Skory-class destroyer, an LST, a salvage ship, and a gunboat), originally purchased for an estimated \$7 million, to Japan for about \$250,000. Ships remaining to be sold include the light cruiser *Irian* (purchased at a discounted cost of \$33 million) and many destroyers, destroyer escorts, and submarines. Indonesia also is attempting to dispose of many of its Communist-supplied bombers, MIG fighters, helicopters, and transports.

4. Because Moscow insisted that Indonesia settle its debt to the USSR before spares would be provided for Soviet military equipment, it was not until after a debt rescheduling in November 1966 that Moscow would agree to sell \$10 million worth of spares to Indonesia. The Soviets, however, in an accord signed in September 1967 refused to provide credit and agreed to sell the spares on a cash basis only. Even then, Indonesia placed orders for only about \$5 million worth of the spares. Delivery of these orders were completed by the end of 1969, after which Soviet-Indonesian arms dealings were terminated. This occurred despite Soviet willingness to provide Indonesia with the remaining \$5 million of spares on credit.

Economic Assistance

5. Moscow's economic aid agreements with Indonesia totaled about \$332 million, of which some \$105 million has been drawn (see Table 3, Appendix A). In contrast to the rapid delivery of sizable amounts of military equipment, not a single industrial establishment was completed with Soviet aid. A dozen merchant ships, a small hospital, some textiles, a sports stadium, roads, and several uncompleted plants comprise the extent of the Soviet legacy to Indonesia's development program.

6. Most of the economic aid allowed 12 years for repayment, after a grace period, and carried interest of 2.5%. The first Soviet economic aid

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to Indonesia was a \$100 million credit extended in 1965 for the construction of roads, the steel mill at Tjilegon, and the superphosphate plant at Tjilatjap and for the purchase of merchant ships. In 1959, Moscow extended a \$17.5 million credit for a sports stadium and a school for shipbuilding and oceanography. The stadium, a showplace for both Indonesians and the USSR, was completed in 1962, in time for the Asian Games. Although little progress was made on the construction of other projects under the 1956 credit, Khrushchev extended another \$250 million of new credits for heavy industrial development during a visit to Indonesia in 1960.

7. Deliveries to Soviet-aided projects continued during the first half of the 1960s, but much of the equipment remained crated at the port or lay rusting at construction sites. Sukarno's preoccupation with the West Irian issue and his "confrontation" with Malaysia diverted much of the country's resources to military use, and Djakarta was unable to provide the local cost financing for the labor and materials necessary to install the equipment. Moreover, the continuing deterioration of Indonesia's economy left Djakarta unable to finance many current budgetary requirements, let alone to pursue its development program. In 1964, at Indonesia's request, approximately \$40 million of the 1960 economic aid credit was diverted to the military, practically the only use of the Khrushchev credit by the time of the halt in Soviet aid activities after 1965.

8. Although the attempted coup did not immediately affect the Soviet-Indonesian aid relationship, the post-Sukarno regime gave higher priority to achieving economic stability and deferred further investments on long-term development projects. This decision particularly affected Soviet-aided industrial projects, causing them to be indefinitely postponed and eventually terminated. As a result, credits totaling some \$215 million, for which contracts had not been entered into under the 1956 and 1960 accords, expired in 1964 and 1967, respectively.

9. Some work, however, continued on the research reactor at Serpong⁽¹⁾ and the shipbuilding and oceanography school at Ambon, but recently, these activities also were stopped. About \$2.5 million from the 1959 credit for the school still remains to be used.

10. The rapid curtailment of Soviet aid activities led to a concomitant drop in the number of Soviet economic technicians employed in Indonesia. In 1963 there were an estimated 430 Soviet economic technicians in Indonesia. The number fell to 100 in 1967, and to only 20 in 1969 and 1970.

1. *Under the 1960 line of credit.*

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SECRETA Hiatus in the Soviet-Indonesian Aid Relationship, 1967-70

11. At the time Moscow terminated its aid activities, Djakarta owed the USSR some \$800 million.⁽²⁾ In spite of Soviet attempts in 1963 to reduce the burden of Indonesia's debt by rescheduling the payments, only about \$60 million of principal and interest had been repaid on the long-term debt by 1965. A second rescheduling was negotiated in November 1966, but Indonesia made no payments under this accord. A new debt settlement was reached in 1970 which allowed the more generous 30-year terms agreed to by Indonesia's Western creditors (see Appendix B). Indonesia made its first payment - about \$16 million - as scheduled in the 1970 protocol on 1 December 1970. The USSR and Indonesia also agreed, under the 1970 protocol, to study the possible completion of the Tjilegon steel mill and the Tjilatjap superphosphate project and to consider Soviet assistance for processing tin and bauxite in Indonesia.

12. Although some reports implied that Indonesia preferred Western assistance for completing the construction of the Soviet-aided plants at Tjilegon and Tjilatjap, Indonesia signed a contract with the USSR in July 1971 for a survey of the plants. The two-month study (for which Indonesia has budgeted \$50,000-\$100,000 for the local costs) will inventory equipment at the sites, will review the original plans to decide whether they should be revised, and will estimate the cost of completing the plants. The report will serve as a basis for Indonesia's decision on whether or not to go ahead with construction of the plants and will determine the amount of additional financial assistance required from the Soviet Union. Preliminary estimates indicate that approximately \$40 million of foreign exchange will be required to put them into operation. About one-fourth

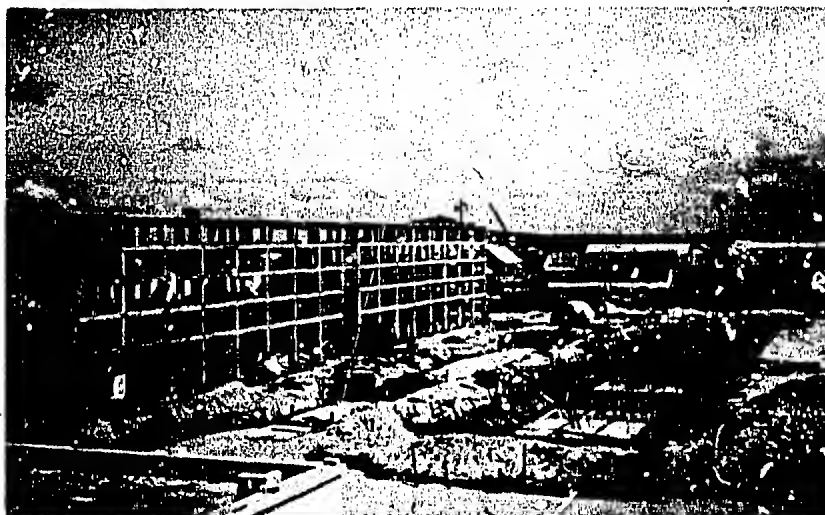
2. Including the following:

	<u>Million US \$</u>
Total debt	799
Long-term debt	<u>748</u>
Military	523
Economic	98
Accumulated interest	127
Medium-term debt	<u>37</u>
Short-term debt, including interest	<u>14</u>

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of the steel plant (see the photograph) and one-half of the superphosphate plant had been completed when Soviet aid was terminated, and roughly 80%-90% of the equipment for the two plants had been delivered at that time. The amount that is salvageable, however, is not known, since much of the equipment either has been stolen, has deteriorated, or has become obsolete.



STEEL PLANT AT TJILEGON, 1967

Prospects for Increased Economic Relations

13. With the return of relative financial stability to Indonesia, it is likely that the government will opt for completion of the steel mill and the superphosphate plant if they are judged to be economically feasible. Though there have been reports that Indonesia would prefer Western assistance for the plants, it would be difficult to solicit the support of Western firms to undertake projects with so large a component of Soviet equipment. A conversion process would be too costly. Therefore, a decision to complete the plants would almost certainly require additional financing from the Soviet Union.

14. Moscow apparently is anxious for a rapprochement, as the USSR is interested in reestablishing a significant political presence in the largest Southeast Asian country. Economic factors are also a consideration. The precipitant decline in Soviet exports to Indonesia after 1965 reversed the USSR's trade balance with Indonesia from a surplus to a deficit (see Table 4, Appendix A). Soviet exports to Indonesia declined from \$54 million

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in 1965 to less than \$5 million in 1966; Soviet imports from Indonesia fell only slightly between 1965 and 1966, from \$32 million to \$31 million. This balance in Indonesia's favor was sustained through 1970. The USSR would like to expand its exports to Indonesia in order to redress the imbalance, particularly since the USSR pays hard currency for its imports from Indonesia. But Soviet participation in Indonesia's total trade was insignificant. With the rise in Indonesia's total turnover to \$2.3 billion in 1970, even if Soviet trade with Indonesia were at the record 1962 level it would account for less than 5% of Indonesia's total trade.

15. As relations between the two countries are normalized, it is likely that Soviet economic aid will flow to Indonesia. This aid, compared with Western assistance was always small (see the chart), and during the next several years probably will be limited to work on the steel mill and superphosphate plant, assuming that their construction is to be resumed. In spite of Soviet interest in providing assistance for tin and bauxite processing plants, this assistance probably will not be undertaken until additional tin and bauxite deposits are exploited, since most of the current production of these metals already has been committed. Japan has contracted to take almost all of Indonesia's current annual output of bauxite -- about 1 million tons -- and tin production does not yet support capacity operations at the government-owned smelter in Indonesia. Thus, even if deliveries of Soviet aid are resumed, the amount provided will be relatively insignificant for Indonesian development, in which foreign private interests plan to invest almost \$1.5 billion (exclusive of oil development). It also will be dwarfed by the far larger aid flows from Western nations, which in 1969 totaled \$350 million.

16. There is no immediate prospect that Indonesia will resume purchases of arms from the USSR. Djakarta not only has curtailed military expenditures, but Indonesia's Defense Department also has recommended against spare parts purchases in spite of reported Soviet offers to provide Indonesia with military equipment and spares on easy terms. The present military establishment in Indonesia appears to prefer to scrap Soviet equipment rather than to purchase more of it.

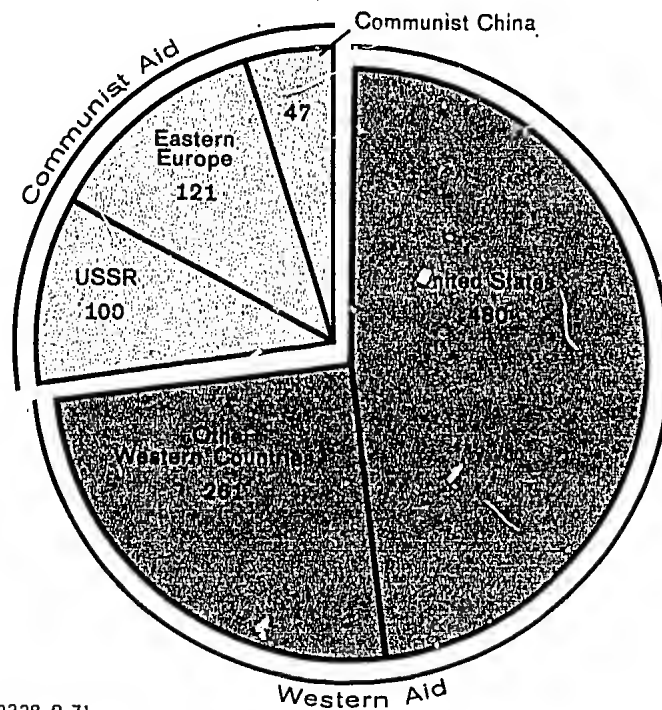
Conclusions

17. The arrival of a Soviet technical team in Djakarta in August to survey two Soviet projects, on which construction was stopped following the abortive local Communist coup in September 1965, could lead to the resumption of Soviet aid to Indonesia. Before the attempted coup, Moscow had delivered some \$860 million of arms and \$100 million of economic aid to Indonesia under agreements totaling about \$1.4 billion.

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Aid Deliveries to Indonesia, 1956-65

Million US \$



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18. The termination of Soviet military deliveries, particularly of spare parts, hit Indonesia's naval and air force particularly hard. Much of the air and naval equipment eventually became useless, and some of it has been sold as scrap to foreign buyers for a small fraction of the original cost. By the time Moscow agreed in 1967 to sell some \$10 million worth of spares, Djakarta had cut back sharply on its military outlays and exercised only half the option. In spite of recent Soviet offers of arms credits, it is unlikely that Indonesia will resume arms purchases from the USSR any time soon.

19. When Soviet economic aid deliveries to Indonesia were stopped, not one industrial project had been completed. Two projects -- a steel mill

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at Tjilegon and a superphosphate plant at Tjilatjap - were only partly completed. An agreement signed in August 1970 to reschedule Indonesia's debt to the USSR called for a survey to determine the feasibility of completing the two projects, as well as for possible assistance for the construction of tin and bauxite processing plants. It is these possibilities that the Soviet technicians will explore.

20. In spite of Moscow's desire to expand its economic ties with Indonesia as a means of establishing a significant presence in that country, Soviet aid is likely to be relatively small because of the limited opportunities presently available for Soviet economic aid involvement. Such assistance is likely to be confined to the two plants and to tin and bauxite processing facilities when additional deposits of these ores are exploited. Soviet economic aid to Indonesia during the next several years also will be insignificant, compared with aid received from Western nations and from anticipated private foreign investment. Official deliveries of aid from the West in 1969 totaled \$350 million, about three and one-half times the amount delivered by the USSR during 1956-65.

21. Moscow also would like to expand its exports to Indonesia in order to redress the imbalance that has characterized its trade with Indonesia since 1966, particularly since the USSR pays hard currency for its imports from Indonesia. Soviet trade with Indonesia, however, always has been relatively insignificant, and even if it were to reach the record level of 1962, it still would account for less than 5% of Indonesia's total trade.

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APPENDIX A

Table 1

Soviet Military Aid To Indonesia

	Million US \$			
	<u>Extended</u>			<u>Drawn</u>
	<u>Total</u>	<u>Credit</u>	<u>Discount</u>	
<i>Total</i>	1,092	824	268	858
1957	8	8		
1959	5	5		
1960	283	200	83	
1961	441	332	109	
1962	95	69	26	
1963	61	51	10	
1964	199	159	40	

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Table 2

Major Communist Military Equipment Delivered
1957-65

<u>Type of Equipment</u>	<u>Units</u>
Naval ships	
Light cruisers	1
Destroyers	16
Submarines	12
Minesweepers	6
Submarine chasers and escort vessels	16
Motor torpedo and missile boats	26
Other, including auxiliary vessels and landing craft	57
Aircraft	
Medium jet bombers	26
Light jet bombers	28
Jet fighters	112
Heavy transports	6
Other, including non-jet combat aircraft, trainers, transports, and helicopters	258
Land armaments	
Light tanks (amphibious)	155
Personnel carriers, armored and amphibious	400
Artillery pieces <u>a/</u>	550
Guided missile systems <u>b/</u>	
Air-to-surface <u>c/</u>	12
Air-to-air <u>d/</u>	26
Surface-to-air <u>e/</u>	8
Surface-to-surface <u>f/</u>	12

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Table 2

Major Communist Military Equipment Delivered
1957-65
(Continued)

-
- a. Including recoilless cannons and mortars over 100 mm in size.
 - b. Data reflect numbers of aircraft, ships, and vehicles having missile capability.
 - c. Indicating number of TU-16 aircraft equipped with ASM (two per aircraft).
 - d. Indicating number of fighter aircraft equipped with AAM (two to four per aircraft).
 - e. Indicating number of SAM firing battalions (sites) -- six launchers per SA-2 site, four launchers per SA-3 site.
 - f. Indicating number of Komar- and Osa-class boats equipped with SSM (two to four per vessel).

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Table 3

Soviet Economic Aid to Indonesia
1956-70

	Million US \$	
	<u>Extended</u>	<u>Drawn</u>
<i>Total</i>	332.2	105.1
1956 Line of credit	100.0	84.0
Of which:		
Ships	12.5	
Textiles	1.0	
Road construction	34.0	
Steel mill	36.0	
Superphosphate plant	8.5	
Farm	1.3	
1959 Credit	17.5	15.1
Sports stadium	12.5	
Shipbuilding and oceanography school	5.0	
1960 Line of credit	210.0 <u>a/</u>	4.1
1960 Hospital <u>b/</u>	1.4	1.4
1965 Trucks	3.3	0.5

a. The original extension of \$250 million was reduced by \$40 million that was transferred to military aid.

b. Grant.

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Table 4

Soviet Exports to and Imports
from Indonesia

Million US \$			
<u>Year</u>	<u>Exports</u>	<u>Imports</u>	<u>Balance</u>
1960	16.2	31.4	-15.2
1961	31.3	33.9	- 2.6
1962	58.6	38.7	19.9
1963	49.9	29.8	20.1
1964	47.1	25.8	21.3
1965	54.4	32.0	22.4
1966	4.8	30.8	-26.0
1967	5.2	24.3	-19.1
1968	5.2	19.1	-13.9
1969	3.6	23.8	-20.2
1970	5.0	27.8	-22.8

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APPENDIX B

Excerpts from Protocol on Economic Relations
Between the Republic of Indonesia
and the USSR, August 1970

Article 1 At the request of the Government of the Republic of Indonesia for the postponement of payments to settle its long-term government debt, and its medium-term and short-term debt, the Government of the Union of Soviet Socialist Republics has agreed that payments for the settlement of debts existing on 1 January 1970, and originating from loans extended under Indonesia-Soviet Union agreements signed on 15 September 1956, 28 February 1960, 22 November 1963, 6 October 1964, 16 May 1965 and Protocols dated 30 April and 13 June 1963, and also based on related contracts between organizations of both parties, will be conducted in 30 years in equal annual installments of 22.5 million rubles (1 ruble contains 0.987412 grams of pure gold), beginning in 1970.

The above-mentioned payments will be made annually on 1 December at the latest.*

Article 2 Payment of interest on long-term government loans, and medium-term and short-term commercial loans in accordance with conditions attached to the agreements and contracts concerned, will be made over a 15-year period beginning in 1985 in equal annual installments amounting to 3.2 million rubles.

These payments will be made annually on 1 December at the latest.

Both parties agree that a moratorium interest will not be charged on the total debt mentioned in Article 1.

* The amounts due for principal, assuming Indonesia takes the option to defer part of payment allowed in Article 3, will be \$15.7 million from 1970 to 1977, \$25.0 million from 1978 to 1991, and \$34.3 million from 1992 through 1999.

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- Article 3** Indonesia may decrease annual installment payments during 1970-77 by 8.4 million rubles a year.
- This amount will be added on to annual payments during 1992-99.
- Interest of 4% a year will be charged for the deferred amount until the deferred payments are settled.
- This interest is to be paid in equal annual installments during 1992-99.
- Article 5** Payments mentioned in Articles 1 and 2 of this Protocol will be made in freely convertible currency at the direction of the State Bank of the Union of Soviet Socialist Republics, into the accounts of the Foreign Trade Bank of the Union of Soviet Socialist Republics in banks of a third country.
- Article 7** Both parties agree to consider completing the construction of the steel project in Tjilegon and the superphosphate project in Tjilatjap.
- Article 8** Both parties agreed to consider the possibility of economic and technical aid by the USSR for processing tin and bauxite in Indonesia.
- Article 10** When this Protocol goes into effect, any provisions contained in other Protocols or agreements noted in Article 1 of this agreement will no longer be valid.